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BEFORE THE
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC

JUL 29 1993

FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF SECRETARY

In the Matter of)
)
Implementation of Sections of the) MM Docket No. 92-266
Cable Television Consumer)
Protection and Competition Act of)
1992; Rate Regulation)
_____)

REPLY COMMENTS OF USA NETWORKS
IN RESPONSE TO FIFTH NOTICE OF PROPOSED RULEMAKING

In its initial comments in this proceeding USA Networks pointed out that there has been a virtual "freeze" by cable operators on the addition of programming services to their offerings to subscribers. As a result of the "freeze", many new services have delayed their launch and fledgling services, like USA Networks' Sci-Fi Channel, have experienced virtual stagnation. We demonstrated that the admittedly-cautious adjustments which the Commission made to its going-forward methodology in its March 30, 1993 Order, however well-intentioned, simply was not (and still is not) working. We submit these reply comments to reinforce the critical need for a meaningful change in the going-forward methodology as it is applied to the addition of new services.

The Freeze on the Launch of New Cable
Programming Services is Pervasive.

It is significant to note that virtually all of the cable networks that filed comments in this proceeding reported that there existed a Commission-induced freeze upon the launch

of new services and the growth of fledgling services. See, e.g., Comments of Arts & Entertainment Network and ESPN at 3-4; Comments of Court TV at 10-12; Comments of Discovery Communications, Comments of E!; Comments of Fox Basic Cable; Comments of Jones Education Network at 2; Comments of Liberty Media Corporation at 4; Comments of USA Networks at 3-5. The freeze pervades every segment of the programming industry. It is not confined to so-called "niche" program services; it affects general entertainment services and specialty networks alike. It does not differentiate between program services with high per-subscriber fees and those with low per-subscriber fees. In fact, the freeze is so pervasive that it seems not to distinguish between program services that the public strongly desires and those that are not in great demand. The simple fact is that, since re-regulation, there has been no significant growth in subscribers to fledgling cable services and that new services face almost insuperable obstacles to launch.

The record also establishes that the principal cause of the freeze is the going-forward rules applicable to new services. The Commission's March 30, 1993 Order, which was intended to provide cable operators with incentives to add new services to a regulated tier, has proven to be woefully inadequate. The unarguable fact is that a cable operator gains very little from the addition of a new service to a regulated tier. When the cost of marketing, promoting and even giving notice are taken into account, it is likely that the cable

operator will lose money in launching a new service. See, e.g., Comments of TCI at 21.

Unless the Commission significantly modifies the current rules, the hundreds of millions of dollars that have been invested in new programming services may be lost forever, to the ultimate detriment of the viewing public. If there were ever any doubt, it is now overwhelmingly clear that the question is not "whether" the going-forward methodology should be changed, but how.

**The Incentives Afforded Cable Operators
to Add New Services to Regulated Tiers
Must be Substantially Increased.**

All of the commenting parties have offered specific, concrete proposals to address the problem of the freeze on the launch and growth of fledgling services. While the particulars of the proposals vary, all rest upon two common principles. The first is that a percentage markup must be replaced with a fixed-fee adjustment. This approach will enable the cable operator to base its editorial decisions relating to the launch of new services on the consideration that should matter--whether the service is likely to be responsive to the interests and concerns of the operators' subscribers. The second is that the per-channel markup must be high enough to provide cable operators with a real incentive to add new services to their systems.

Meetings with Commissioners and staff suggests a concern that if the markup on new services were "too generous" it would have the effect of inducing cable operators to

promiscuously add new services to regulated tiers in order to increase rates and net profits.

This concern is baseless for both analytic and practical reasons. As an analytic matter, the concern that cable operators will load up regulated tiers rests on an assumption that consumer response to increased rates associated with additional services is perfectly inelastic. But, it has never been shown that this is the case. Indeed, the available studies of historic rate increases associated with increased service--such as those performed by the GAO--suggests the contrary. As a practical matter, cable operators simply cannot load up their regulated tiers with new services without risking stagnation or loss of penetration. Moreover, with the recent start-up of well-financed national DBS distributors, cable operators will have to operate in a competitive market. The notion that the fixed fee approach of not less than 25 cents may be too generous is itself economically irrational. The market will correct itself if it is.

In addition, there is evidence in the record which shows that a fixed markup of not less than 25 cents is reflective of conditions that would prevail in an unregulated, competitive market. TCI has submitted with its comments an analysis prepared by Charles River Associates presenting a "competitive markup." Comments of TCI Attachment A at 23. The approach taken by Charles River Associates is very similar to that undertaken by the Commission in the development of the benchmark itself. TCI has attempted, from publicly-available

data, to measure average rate increases associated with the addition of new services prior to the reimposition of rate regulation and it has adjusted these calculations to reflect the Commission's calculated "competitive differential." Comments of TCI Attachment A at 2. The results calculated by Charles River Associates are similar to the result which we, and other cable programmers, have reached based upon our pragmatic assessment of probable marketplace reaction. The Charles River Associates study shows that a "competitive markup" of between 21 and 34 cents is appropriate. Comments of TCI Attachment A at 3. For the majority of systems, the approach USA Networks advocated in its comments would result in a markup of 31 cents, well within the range of the Charles River Associates analysis.

A primary goal of rate regulation is to replicate, as nearly as practicable, conditions that would exist in a fully competitive market. The proposal that USA Networks has advanced is based upon our pragmatic assessment of probable marketplace reaction, and it is confirmed by the competitive market analysis performed by TCI. We cannot be sure that the solution which we have advanced will be sufficient to end the freeze upon the launch of new services and the growth of fledgling services. However, the record leaves absolutely no room for doubt that the Commission's current approach is not working. We believe that the approach which we have recommended properly balances the requirements of rate regulation with the fundamental policy objective of promoting

greater diversity through new speakers and new, innovative programming services.

Respectfully submitted,



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July 28, 1994